85-1250

No. _____

Supreme Court, U.S.
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IN THE
Supreme Court of the United States
OCTOBER TERM, 1985

TRUNKLINE GAS COMPANY

and

PANHANDLE EASTERN PIPE LINE COMPANY,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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January 23, 1986

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QUESTIONS PRESENTED

1. Whether the Natural Gas Act, 15 U.S.C. §§ 717-717w, and the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432, administered from their inception as applying public utility service obligation and rate-making standards to natural gas pipelines, may be re-interpreted validly to require pipelines to engage in head-to-head price competition for service to their previously certificated markets.

2. A. Whether the due process requirements of the Fifth Amendment to the Constitution were violated by the squeeze applied by the Commission's elimination of the operative minimum bill and minimum take provisions of pipeline sales contracts with their customers, in conjunction with its refusal to modify similarly the equivalent obligations in the pipeline purchase contracts with producers.

B. Whether these same requirements were not violated by the Commission's attempt to force all pipelines' sales rates to a single level when some pipelines' costs are much higher than others' as a direct result of the multi-tiered wellhead rate structure mandated by the NGPA.

LIST OF PARTIES

The parties to the proceeding in the Court of Appeals are as follows:

Algonquin Gas Transmission Corporation
ANR Pipeline Company
Arkansas Louisiana Gas Company,
a Division of Arkla, Inc.
Cascade Natural Gas Corporation
City Gas Company
Great Lakes Gas Transmission Company
Madison Gas & Electric Company
MIGC, Inc.
Midwestern Gas Transmission Company
Northwest Natural Gas Company
Pacific Interstate Offshore Company
Tennessee Gas Pipeline Company
Texas Eastern Transmission Company
Texas Gas Transmission Company
Transcontinental Gas Pipeline Corporation
Washington Natural Gas Company
Wisconsin Fuel & Light Company
Wisconsin Gas Company
Wisconsin Natural Gas Company
Wisconsin Power & Light Company
Wisconsin Public Service Commission
Aluminum Association
American Iron and Steel Institute
Association of Businesses Advocating Tariff Equity:

Abitibi-Price Corporation
BASF Wyandotte Corporation
The Budd Company
Bundy Corporation
Chrysler Corporation
Clark Equipment Company
Detroit Strip Division of Cyclops Corporation
Dow Chemical U.S.A.
Dundee Cement Company

Eaton Corporation
Edward C. Levy Company
Escanaba Paper Company
Ford Motor Company
General Motors Corporation
Great Lakes Steel Division of
National Steel Corporation
Haworth Manufacturing, Inc.
Hayes-Albion Corporation
Huron Valley Steel Corporation
James River Corporation
Kastle Steel Corporation
Marblehead Lime Company
McLouth Steel Corporation
Menominee Paper Company
Michigan Sugar Company
Monsanto Company
Mueller Brass Company
National Standard Company
Pennwalt Corporation
Quanex Corporation.
Steelcase Inc.
TRW
Wolverine Aluminum Corporation

Brooklyn Union Gas Company
Consolidated Gas Transmission Corporation
Consumers Power Company
El Paso Natural Gas Company
Foothills Pipeline (Yukon) Ltd. and
Pan-Alberta Gas Ltd.
Georgia Industrial Gas Group:

American Industrial Clay Company
of Sandersville
Anglo-American Clays Corporation
Burgess Pigment Company
Engelhard Corporation
Mineral & Chemicals Division, Nabisco, Inc.

Nord Kaolin Company
Thiele Kaolin Company

Inter-City Gas Corporation
Michigan Consolidated Gas Company
Michigan Gas Utilities Company
Natural Gas Pipeline Company of America
Northern Illinois Gas Company
Peoples Gas Light and Coke Company
Process Gas Consumers Group:

American Can Company
American Standard Inc.
Armco Inc.
Bethlehem Steel Corporation
Borg-Warner Corporation
Cone Mills Corporation
Corning Glass Works
General Motors Corporation
Owens-Corning Fiberglass Corporation
Owens-Illinois, Inc.

Public Service Commission of the State of New York
Public Utilities Commission of the State of California
State Corporation Commission for the State of Kansas
Chattanooga Gas Company, a Division of Jupiter Industries, Inc.
Colorado Interstate Gas Company
Columbia Gas Transmission Corporation
Kansas State Corporation Commission
Northwest Energy Company
Pacific Gas and Electric Company
Pacific Gas Transmission Company
Pacific Interstate Offshore Company and Pacific Offshore Pipeline Company
Public Service Electric and Gas Company
Southern California Gas Company and Pacific Lighting Gas Supply Company

State of Michigan and
Michigan Public Service Commission
TransCanada Pipelines Limited
Washington Gas Light Company

The following listed companies are subsidiaries or affiliates of Panhandle Eastern Pipe Line Company and/or Trunkline Gas Company, petitioners herein:

Anadarko Production Company
Aurora Industries, Inc.
Century Refining Company
Dixilyn-Field Drilling Company
Energy Pipelines International Company
Faskure Technology, Inc.
Illinois Napgas Company
Mantaray Pipeline Company
Matagorda Island Development Corporation
Matagorda Island Exploration Corporation
Pan Alaska Gas Company
Pan Border Gas Company
Pan Eastern Coal Company
Pan Eastern Exploration Company
Pan Gas Storage Company
Panhandle Canadian Gas, Limited
Panhandle Eastern Corporation
Panhandle Eastern Pipe Line Company
Panhandle Trading Company
Panhandle Western Gas Company
PanMark Gas Company
Pelmar Company
Southwest Gas Storage Corporation
Stingray Pipeline Company
Trunkline Gas Company
Trunkline LNG Company
Trunkline Offshore Company
Wycoalgas, Inc.
The Youghiogheny and Ohio Coal Company

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FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Trunkline Gas Company and Panhandle Eastern Pipe Line Company hereby petition for a writ of certiorari for review of the decision of the Court of Appeals for the District of Columbia Circuit in *Wisconsin Gas Co. v. Federal Energy Regulatory Commission*, No. 84-1358, *et al.* (D.C. Cir. August 20, 1985).

OPINIONS BELOW

The decision of the Court of Appeals is reported at 770 F.2d 1144 and appears at Pet. App. A.[1] The Court of

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[1] References to "Pet. App. ——" appearing herein are to the Appendix to the Petition for Writ of Certiorari to the United

Appeals' orders denying rehearing and denying rehearing *en banc*, both dated October 25, 1985, are not officially reported and appear at Pet. Apps. B and C, respectively. The orders of the Federal Energy Regulatory Commission which were affirmed in part by the Court of Appeals, and are the subject of this petition, are: (a) Order No. 380, reported at 27 FERC (CCH) ¶ 61,318, and appearing at Pet. App. D; and (b) Order No. 380-A, reported at 28 FERC (CCH) ¶ 61,175, and appearing at Pet. App. E.

JURISDICTION

The decision of the Court of Appeals and its judgment in this case were entered August 20, 1985. A timely petition for rehearing and suggestion for rehearing *en banc* were denied by orders entered on October 25, 1985. This Court has jurisdiction to review the decision below under 15 U.S.C. § 717r(b) and 28 U.S.C. § 1254(1).

CONSTITUTIONAL AND STATUTORY PROVISIONS

The Fifth Amendment to the United States Constitution provides: "No person shall be . . . deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation." Statutory provisions at issue herein include Sections 5(a) and 7(c) of the Natural Gas Act, 15 U.S.C. §§ 717d(a) and 717f(c), reproduced at Pet. App. I; Sections 4(a) and 4(e) of the Natural Gas Act, 15 U.S.C. §§ 717c(a), (e), reproduced at Trunkline/Panhandle App. A; and Section 601 of the Natural Gas Policy Act of 1978, 15 U.S.C. § 3431, reproduced at Trunkline/Panhandle App. B.

States Court of Appeals for the District of Columbia Circuit filed January 21, 1986 in *Transwestern Pipeline Co. v. Federal Energy Regulatory Commission*, No. 85-1219, in which Transwestern Pipeline Company is seeking certiorari of the Court of Appeals judgment which is also the subject of the instant petition. Two additional appendices, Trunkline/Panhandle Appendices A and B are attached hereto. Finally, references herein to "J.A. ——" are to the Joint Appendix filed by the parties in the Court of Appeals proceeding.

STATEMENT OF THE CASE

Under the Natural Gas Act and the Natural Gas Policy Act of 1978, the natural gas pipeline industry has been regulated as a public utility, with pipeline construction, operation and rates subject to Federal Energy Regulatory Commission regulation, to ensure efficiency and to prevent wasteful competition for core markets. Under that regime, and under the multi-tiered wellhead pricing provisions of the NGPA, pipelines have arrived at divergent individualized cost recovery needs. Commission Orders No. 380 and 380-A, affirmed by the Court of Appeals and under review herein, have restructured long-standing pipeline minimum bill provisions in a manner intended to throw pipelines open to unbridled head-to-head competition and to force the gas cost component of all pipeline rates down to a single, lowest-common-denominator level.

A. Historical Background

Trunkline Gas Company (Trunkline) and Panhandle Eastern Pipe Line Company (Panhandle), petitioners herein, are major interstate natural gas pipelines, subject to the regulatory jurisdiction of the Federal Energy Regulatory Commission (Commission) under the Natural Gas Act (NGA), 15 U.S.C. §§ 717-717w and the Natural Gas Policy Act of 1978 (NGPA), 15 U.S.C. §§ 3301-3432. As such, and like other major natural gas pipelines, they operate capital plants with aggregate investments amounting to many hundreds of millions of dollars, facilities constructed and operated under certificate authority granted by the Commission (and its predecessor, the Federal Power Commission (FPC)), pursuant to the requirements of Section 7 of the NGA, 15 U.S.C. § 717f. As sellers of natural gas, both Trunkline and Panhandle have public utility obligations to provide to their customers, on demand, a maximum quantity of natural gas specified in their service agreements with customers (the "contract quantity").

Because of pipelines' need to recover enormous capital investments and to acquire long-term gas supplies, this Court has long recognized that competition between pipelines must of necessity be somewhat limited: once a pipeline is certificated by the Commission to serve particular customers' needs, that portion of the market is committed during the contractual term in the absence of significant changes in conditions, though other pipelines are free to compete for incremental markets, subject to Commission review for compliance with its standards of public convenience and necessity. *See, e.g., United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 659-60 (1964). This has been the structure of the industry since the passage of the NGA. Consistent therewith, the NGA does not contemplate that a pipeline's natural gas resale rates be set by the marketplace; instead, it requires that such rates be set at a "just and reasonable" level, by the pipeline in the first instance, subject to Commission adjustment if necessary under the "utility-type ratemaking" standards of the Act. 15 U.S.C. §§ 717c, 717d (1982); *see Transcontinental Pipe Line Corp. v. State Oil and Gas Board of Mississippi*, U.S. No. 84-1076, slip op. at 10 (January 22, 1986).

In order to ensure that they have sufficient gas supplies to meet their sales obligations, Trunkline, Panhandle and other interstate pipelines have made long-term contracts for the purchase of large quantities of natural gas from producers and other suppliers. While these contracts typically give Trunkline and Panhandle some flexibility in the amount and timing of their takes, the pipelines have agreed to take (or pay for) certain minimum quantities of gas on a periodic basis. In return for these "take-or-pay" provisions—which, in effect, require the pipelines to purchase minimum amounts of the gas committed to them—producers have consented to long-term dedications of gas reserves to Trunkline and Panhandle. J.A. 1249-54. These long-term contracts, with take-or-pay provisions, are "standard industry-wide." *Transcontinental Pipe Line Corp.*, U.S. No. 84-1076, slip op. at 13, 15.

Until the actions on which review is sought herein, the Commission (and the FPC before it) recognized that a similar exchange of commitments was just and reasonable as between a pipeline and its customers. Thus, under its authority to regulate rates and charges under Sections 4 and 5 of the NGA, 15 U.S.C. §§ 717c, 717d, the Commission regularly approved "minimum commodity bill" provisions in pipeline service agreements and tariffs for the pipeline's "partial requirements" customers —which account for 95 per cent of Trunkline's system sales and 60 per cent of Panhandle's. J.A. 1252-53.[2] Under these provisions, in exchange for the pipeline's commitment to sell it gas, a customer's bill would be calculated for each relevant period as though the customer had purchased a specified minimum amount of gas —in economic effect, inducing the customer to purchase that minimum amount. The purchase commitment thus assumed by the customer was not equal to the entire sales commitment of the pipeline, as it would typically be in an ordinary commercial sales contract. Instead, the customer's minimum bill specifies a lesser percentage of that quantity—75 per cent in the cases of Trunkline and Panhandle. J.A. 1251-52.

As the natural gas shortage of the mid-1970s developed, it became apparent that the traditional NGA regime of closely regulated—and artificially depressed—wellhead prices was not working adequately to spur suffi-

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[2] "Partial requirements" customers are, as the term implies, those customers which take only a *part* of their requirements from the pipeline in question, typically purchasing the remainder of their requirements from a second pipeline. Historically, the partial requirements customer (whether a utility or another pipeline) would have contracts with each pipeline selling to it, specifying the volume or percentage that would constitute the minimum take obligation. A pipeline's "full requirements" customers—those who purchase all their gas requirements from the pipeline—are typically not subject to minimum commodity bill provisions, since their purchases will always be equal to the full amount of their requirements. Pet. App. A at A-19.

cient production to meet the country's gas needs. The legislative response was the passage in 1978 of the NGPA. Therein, Congress established a system of incentive pricing for gas sold at the wellhead, dividing gas into a number of categories. Within the "new" categories of gas—*i.e.*, those wells which, prior to the passage of the Act, were not dedicated to the interstate market—the prices permitted to be charged by producers for first-sales were to rise gradually through a several-year transition period and ultimately to be deregulated, thereby spurring the needed new production. "Old" gas—that coming from wells completed and dedicated to interstate commerce before the passage of the NGPA—was to remain much lower in price than new gas and was to remain forever regulated. *Public Service Commission of New York v. Mid-Louisiana Gas Co.*, 463 U.S. 319 (1983); 15 U.S.C. §§ 3301-3432. Unlike wellhead prices, the sales rates which pipelines are permitted to charge remained subject to Commission regulation under Sections 4 and 5 of the NGA. 15 U.S.C. §§ 717c, 717d. In order to ensure that the producer incentives established by the NGPA were not indirectly stymied by Commission rate regulation of pipelines, however, Congress provided in the NGPA that, absent a showing of fraud, abuse or similar grounds, pipelines are entitled automatically to pass through to their customers any costs of purchased gas paid to first sellers which are within the NGPA price ceilings. 15 U.S.C. § 3431(b), (c).

The NGPA had two fundamental effects on the natural gas industry. First, it did indeed spur production as intended—so much so that the result was, as the Commission has been at pains to point out, a gas surplus presently existing. Pet. App. D at A-79 to A-80. Second, however, the NGPA created a permanent and highly artificial inequality between various pipelines' costs of service. Those pipelines which happened to have acquired large quantities of old gas in proportion to their total

needs had a very low average cost of purchased gas when compared to other pipelines—such as Trunkline—with a higher proportion of new gas, because old gas first-sale prices were artifically constrained to a level as little as one-third or less of those of most new gas.

Trunkline's vulnerability is particularly exacerbated by the fact that virtually all its customers are partial requirements customers whose alternative suppliers have a significantly lower-cost gas mix than Trunkline, due in large part to those suppliers' higher reserves of old gas. This disparity in cost results from Trunkline's great diligence in embracing the goals of the NGPA by engaging in a number of new gas supply projects—including purchases of additional higher-cost domestic gas as well as imported liquefied natural gas (LNG) from a new facility approved by the Commission as being in the public convenience and necessity. J.A. 1256-57. Similar conditions exist in the case of Panhandle. In its rulemaking under review herein, the Commission did not address how a pipeline in Trunkline's or Panhandle's position can possibly be expected to engage in head-to-head price competition with other pipelines while under such an innate disadvantage.

B. The Commission's Rulemaking

In August 1983, the Commission issued a Notice of Proposed Rulemaking in which, for the first time, it proposed to dramatically reduce the level and effectiveness of minimum bill provisions by removing all of a pipeline's variable costs—including, most importantly, its cost of purchased gas—from recovery in such bills. The Commission's stated concern was that pipelines might recover a windfall through minimum bills if they charged their customers for gas not actually taken. *Elimination Of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions,* 48 Fed. Reg. 39,238 (1983).

Substantial evidence was introduced before the Commission demonstrating that no such problem existed because customers of pipelines fulfilled their commitments by physically taking at least the minimum bill amounts of gas, which was the objective of the minimum bill provisions. J.A. 1252, 1522-23. Nonetheless, the Commission prescribed and is enforcing a new rule that eliminates all costs of purchased gas from existing minimum bill coverage and prohibits variable costs of any kind from being recovered via minimum bills in future tariff filings. *Elimination Of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions (Order No. 380)*, 27 FERC (CCH) ¶ 61,318 (1984); Pet. App. D. The Commission concluded that such minimum bills were "anti-competitive" in that they discouraged a pipeline's customers from reducing or ceasing purchases from the pipeline in order to purchase from a source (generally speaking, a second pipeline) offering a lower price. The Commission did not distinguish this effect from the identical deterrent effect of ordinary commercial purchase contracts. The Commission also failed to reconcile this result—which contemplated direct price competition between pipelines for core, certificated markets—with previous cases under the NGA, which held that inter-pipeline competition is for incremental markets, not for previously certificated markets.

C. The Decision of the Court of Appeals

Timely petitions for Commission rehearing having been denied in most respects,[3] Trunkline, Panhandle and approximately fifteen other parties petitioned the United

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[3] *Elimination Of Variable Costs From Certain Natural Gas Pipeline Minimum Commodity Bill Provisions (Order No. 380-A)*, 28 FERC (CCH) ¶ 61,175 (1984); Pet. App. E. The Commission also issued a number of subsequent orders in the proceedings, but Trunkline and Panhandle have not sought review of those orders before the Court of Appeals. *See* 29 FERC (CCH) ¶ 61,077 and 29 FERC (CCH) ¶ 61,332 (1984).

States Court of Appeals for the District of Columbia Circuit for review of the Commission's order and of the denial of rehearing, pursuant to that court's jurisdiction under 15 U.S.C. § 717r(b). The Court of Appeals affirmed, *Wisconsin Gas Co. v. FERC*, 770 F.2d 1144 (D.C. Cir. 1985); Pet. App. A, finding that "each of the order's essential elements is supported by substantial evidence" and that "the Commission has given reasoned consideration to each of the pertinent factors." Pet. App. A at A-42. The court remanded the orders of the Commission in one respect, holding that the Commission erred when it provided that fixed charges levied in the minimum bill by one pipeline on a "downstream" pipeline could not be passed along as fixed costs by the downstream pipeline. Pet. App. A at A-46 to A-50.

REASONS FOR GRANTING THE WRIT

The Commission's sudden rearrangement of long-settled sales arrangements in the natural gas industry violates the public utility standards upon which the NGA was founded—a market structure firmly entrenched by years of practice thereunder and by established court precedent. *See United States v. El Paso Natural Gas Co.*, 376 U.S. 651, 659-60 (1964); *Transcontinental Pipe Line Corp.*, U.S. No. 84-1076, slip op. at 10. Moreover, the Commission's action was taken entirely without regard for its effects on the disparate cost-recovery requirements and competitive positions of individual pipelines—disparities caused by the policies of the NGPA. The Commission has no authority under present statutes to make these basic changes in the industry, and the Commission's action is therefore unlawful absent further legislative command.

The practical result of the Commission's disregard for the policies of its two governing statutes is to entirely deny pipelines such as Trunkline and Panhandle a fair opportunity to recover their costs. Coupled with their continuing public utility obligations, this amounts to a con-

fiscation of their property without due process of law and without just compensation, in violation of fundamental principles of public utility ratemaking which are based on the Fifth Amendment to the Constitution. *FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944); *FPC v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585 (1942); *West Ohio Gas Co. v. Public Utilities Commission of Ohio*, 294 U.S. 63 (1935). This action also necessarily results in a rate which is not "just and reasonable" as required by Sections 4 and 5 of the Natural Gas Act, 15 U.S.C. §§ 717c, 717d. *FPC v. Hope Natural Gas Co.*, 320 U.S. at 603.

I. The Commission's Orders Attempt To Impose Head-To-Head Competition On The Natural Gas Pipeline Industry, In Violation Of The Public Utility Standards Of The Natural Gas Act And The Natural Gas Policy Act Of 1978.

The Commission's action on which certiorari is sought was premised on opening pipelines' core sales markets to direct head-to-head price competition—a policy antithetical to the closely regulated market structure established by the NGA. This Court has made clear the nature of the gas pipeline industry as governed by the NGA:

> This is not a field where merchants are in a continuous daily struggle to hold old customers and to win new ones over from their rivals. In this regulated industry a natural gas company . . . must compete for, enter into, and then obtain Commission approval of sale contracts in advance of constructing the pipeline facilities. In the natural gas industry pipelines are very expensive; and to be justified they need long-term contracts for sale of the gas that will travel them. . . . Once the Commission grants authorization to construct facilities or to transport gas in interstate commerce, once the distributing contracts are made, a particular market is withdrawn

> from competition. *The competition then is for the new increments of demand that may emerge with an expanding population and with an expanding industrial or household use of gas.*

United States v. El Paso Natural Gas Co., 376 U.S. at 659-60 (emphasis in original).[4] *See also Northern Natural Gas Co. v. FPC*, 399 F.2d 953 (D.C. Cir. 1968); *Panhandle Eastern Pipe Line Co. v. FPC*, 169 F.2d 881 (D.C. Cir.), *cert. denied*, 335 U.S. 854 (1948).

The Court's conclusion that the market structure established by the NGA foreclosed unbridled competition among pipelines is borne out by the Act's legislative history. When the Act was amended in 1942 to require Federal Power Commission certification for any pipeline construction or operation of facilities, the responsible House Committee described the purpose of this change:

> Section 7(c), as at present in force, regulates competition in the public interest by preventing uneconomic extensions and allowing those extensions which are in the public interest and in accord with the policy of the statute; but it so regulates only in case of extensions to "a market in which natural gas is already being served by another natural-gas company." *The present section consequently allows unregulated competition in extensions and even economic waste in the construction of new interstate natural gas pipe lines*, by natural gas companies subject to the Natural Gas Act in all other cases. Such a natural gas pipe line, as soon as it is constructed, it should be noted, comes within the Commission's jurisdiction and is subject to regulation as a facility used for the transportation of natural gas in interstate commerce. Obviously adequate regulation of such pipe lines when con-

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[4] The Court's description was not a mere statement of fact—it was intended to delineate the nature of "competition" within the industry, for purposes of applying the *legal* standard of probability of harm to competition under Section 7 of the Clayton Act, 15 U.S.C. § 18.

> structed requires that the Commission also have jurisdiction to regulate construction and initial financing. By the unregulated construction of a pipe line, uneconomic construction, or inflated costs may make proper regulation of operation thereafter difficult or practically impossible. The bill when enacted will have the effect of giving the Commission an opportunity to scrutinize the financial set-up, the adequacy of the gas reserves, the feasibility and adequacy of the proposed services, and the characteristics of the rate structure in connection with the proposed construction or extension at a time when such vital matters can readily be modified as the public interest may demand.

H.R. Rep. No. 1290, 77th Cong., 1st Sess. 2-3 (1941) (emphasis added). As noted, even the originally-enacted version of the NGA required that a certificate be obtained prior to entering "a market . . . already being served by another natural-gas company," contemplating close regulatory control over inter-pipeline competition. Moreover, Section 7(c) was expressly intended, in part, to prevent "cutthroat" competition by ensuring that, in certificating multi-pipeline markets, due consideration would be given by the Commission to the sufficiency of each pipeline's reserves to provide adequate service in the long-term, and that the Commission *not* merely approve the provision of lower rates of a transient nature. 84 Cong. Rec. 9101 (1938). In short, the intent of Section 7(c) was to prevent "wasteful" competition by strictly regulating the extent to which pipelines could build and operate facilities in competition with each other.

As a part of its mandate under the NGA, the Commission is also called upon to ensure that "just and reasonable" rates are charged by pipelines. 15 U.S.C. §§ 717c, 717d. But this does not mean, as the Commission would have it, using the marketplace to force a pipeline to charge a rate equal to the lowest rate charged by any other pipeline in its market area. First, the concept of

"just and reasonable" rates requires a *balance* between the pipeline's financial health and the consumers' interests, not merely a reflexive setting of the lowest price conceivable. *See, e.g., FPC v. Memphis Light, Gas & Water Division*, 411 U.S. 458, 465-66, 474 (1973); *FPC v. Hope Natural Gas Co.*, 320 U.S. at 603, 610. Second, it is legal error to presume, as the Commission does here, that whatever price is forced on a pipeline by its competitors is just and reasonable for NGA purposes; this Court has flatly rejected previous Commission reliance on the marketplace to set just and reasonable rates. *See FPC v. Texaco, Inc.*, 417 U.S. 380, 397-99 (1974).

Nor has the statutory policy of the NGA as to the limits on inter-pipeline competition been changed in any way by the passage of the NGPA in 1978, which patently applies only to gas production sales, not to pipeline sales, which remain fully regulated under the NGA. Even as to the wellhead market, the Commission's view in Order No. 380 that the policy of the NGPA was to mandate an "increasingly competitive wellhead market [with] an opportunity for gas prices to increase or decrease—whichever the market demands" (Pet. App. D at A-88) is not supported by the legislative history. Rather, Congress intended for prices to *rise* gradually to a level no longer subject to regulation in order to spur new gas production. Thus, in the House Report on the bill which became the NGPA, the Committee on Interstate and Foreign Commerce stated: "[the new] pricing policy must recognize the costs and risks associated with finding new supplies of natural gas and provide positive price incentives to encourage expanded exploration for, and development of, our Nation's valuable domestic natural gas resources." H.R. Rep. No. 95-496, Part 4, 95th Cong., 1st Sess., 101 (1977). This Court, too, has recognized that the legislative purpose of the NGPA was to provide incentives for gas production by permitting wellhead prices to *rise*. *See*

Public Service Commission of New York v. Mid-Louisiana Gas Co., 463 U.S. 319 (1983); *Transcontinental Pipe Line Corp.*, U.S. 84-1076, slip op. (dissent) at 7-8.

In short, the NGPA was intended to drive *producer* prices *up*; the Commission's belief that it supports regulatory action designed to drive pipeline prices *down* is therefore perverse. But it is more than that—it is contrary to the express mechanism of NGPA Section 601 (b) and (c), 15 U.S.C. § 3431(b), (c), which guarantees interstate pipelines the right, absent fraud, abuse or similar grounds, to pass through to their customers the costs of purchasing gas in first sales if those costs do not violate the NGPA ceilings or are not subject to any ceiling. That section plainly contemplates that the Commission may not use its power to regulate the sales rates of pipelines to impose an indirect regulatory impact on the wellhead market.[5] Yet it was the Commission's express intent herein to exert downward pressure on wellhead prices via the mechanism of regulating pipelines (Pet. App. D at A-87, A-100)—a result plainly contrary to the purpose of Section 601.

The Commission's assertion that its action is justified because of changes in the marketplace since the passage of the NGPA is plainly erroneous. Throughout the history of the gas industry it is apparent that in every instance in which more than one pipeline serves a cus-

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[5] Even before the passage of the NGPA, such indirect regulation of producer prices by the mechanism of imposing controls on pipelines' recovery of gas costs was accepted by this Court only in the context of a regulatory "experiment" subject to "close review" by the FPC, and only if the FPC took pains to ensure that pipelines did not run an unfair "risk of incurring unrefundable expenses that may later be disallowed." *FPC v. Texaco, Inc.*, 417 U.S. at 392-93. Unlike the *Texaco* case, the Commission here has—entirely without a period of experimentation—imposed a new indirect regulatory regime on all pipelines for all time. And the "risk" of pipelines' being unable to recover their previously incurred costs is in many cases a virtual certainty.

tomer or a region, disparate prices would exist; in fact, the reason for prescribing minimum bill provisions in partial requirements contracts and tariffs was to prevent displacement of certificated suppliers, even though higher priced than other available sources. Pet. App. D at A-79 to A-81, A-94. To convert a public utility standard of regulation into a competitive price struggle is a drastic change that is inconsistent with the framework established by the NGA and NGPA. Such fundamental changes require legislation and are well beyond the scope of the Commission's rulemaking power. *See FPC v. Texaco, Inc.*, 417 U.S. at 400.[6]

II. The Commission's Actions Are Unlawfully Confiscatory Because They Deny Pipelines Their Customers' Purchase Commitments Without Relieving Pipelines Of Their Own Purchase Commitments, And Because They Deny Pipelines The Right To Recover Their Costs Under The Two-Tiered Structure Of The NGPA.

The Commission's orders, contrary to the policies of the NGA and NGPA, have created a variety of serious eco-

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[6] The regulatory structure of the NGA was based in large part on the model previously established by the Interstate Commerce Act and the Motor Carrier Act, 49 U.S.C. §§ 1, 306-08. *See* H.R. Rep. No. 709, 75th Cong., 1st Sess. 6 (1937). While the industries subject to those acts have been subjected to increasing head-to-head competition in recent years, this has been accomplished only by the passage of new legislation entirely revamping the statutory structure of the acts. *See, e.g.*, Pub. L. No. 95-473, 92 Stat. 1466 (1978). This history is further evidence that the Commission's attempt to recast in a similar fashion the parallel regulation of the natural gas industry can be accomplished only by Congressional action.

It may be noted that more recently, in proceedings still undergoing Court of Appeals review, the Commission embarked still further on its restructuring of the gas pipeline industry by prescribing common carrier transportation requirements for pipelines that transport *and* simultaneously permitting pipeline sales customers to reduce or eliminate their contract quantities. *See Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol (Order No. 436)*, 49 Fed. Reg. 42,408 (1985); *see also* note 7, *infra*.

nomic problems for pipelines amounting to forbidden confiscation in many cases. In the case of Trunkline—virtually all of whose certificated customers have other pipeline suppliers—the effect of the rule is confiscatory because it penalizes Trunkline for its Commission-sanctioned attempts to aggressively develop new gas supply services in direct pursuance of the policy of the NGPA. To replenish its gas supplies in order to serve certificated markets, Trunkline invested many millions of dollars in a number of gas supply areas, and agreed to take-or-pay clauses with its suppliers in exchange for assurances that gas would be available. Moreover, as a result of Trunkline's energetic gas acquisition programs, Trunkline's gas supply became heavily weighted toward new gas. Because of the NGPA's provisions for high incentive-pricing for new gas coupled with the Commission's continuing regulation of old gas prices at relatively low levels, these acquisitions resulted in Trunkline having a more expensive overall gas supply mix than many other pipelines.

As noted, Trunkline's aggressive gas acquisition practices were made possible *only* by the fact that its sales were certificated by the Commission with tariff provisions anchored by minimum commodity bills. Some 95 per cent of Trunkline's system sales are to partial requirements customers that have other suppliers. J.A. 1253. Before taking steps which would both commit huge amounts of funds to take-or-pay arrangements with suppliers and would unavoidably require the cost of Trunkline's gas supply mix to rise, Trunkline and also Panhandle had Commission-approved contractual assurances that their customers—for whose benefit those programs were undertaken—would not desert them when industry supply and demand balances were restored. The minimum commodity bill tariff provisions—incorporated in Trunkline's *contracts* with its customers—provided these assurances. Similar considerations apply to Panhandle, Trunkline's largest customer, which makes 60 per cent of its system sales to partial requirements customers. *Id.* The action

taken by the Commission has now virtually destroyed Trunkline's and Panhandle's property interest in these contracts.

Moreover, the Commission's attempt to force all pipeline rates to a single, lowest level is confiscatory because it ignores the intrinsically higher costs imposed on many pipelines under the two-tiered NGPA. In the new, theoretically "pure" pipeline competition envisioned by the Commission's order, Trunkline and Panhandle, as well as other pipelines, have become victims of their own diligence in pursuing the goals of the NGPA. Fair inter-pipeline competition is a chimera because the burden of relatively expensive new gas in the supply mix can be avoided only at the equaliy burdensome cost of massive take-or-pay exposure to the producers. In Trunkline's case, this exposure now exceeds $1 billion. Thus, Trunkline faces the dilemma of lowering prices to a level below its costs or losing much or most of its gas sales market, at the risk of not recovering its take-or-pay and other costs. As a result, Trunkline's very viability as a continuing entity is threatened. And in this context, the theoretical competitive benefits cited by the Commission are without weight—as this Court has made clear, in determining whether Commission rate orders are just and reasonable, "[i]t is not theory but the impact of the rate order which counts." *FPC v. Hope Natural Gas Co.*, 320 U.S. at 602. *Accord, Electricity Consumers Resource Council v. FERC*, 747 F.2d 1511, 1514 (D.C. Cir. 1984).[7]

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[7] To ameliorate this confiscatory effect, the Commission might have taken action within its power to eliminate the NGPA-fostered competitive disparity—for instance, by taking steps to relieve Trunkline, Panhandle and similarly situated pipelines of their heavy take-or-pay burdens within the Commission's remaining jurisdiction over many gas first-sales contracts. Indeed, such a step seems obvious, since by the Commission's own reasoning, take-or-pay clauses are "anti-competitive" and may lead to windfalls to producers. Moreover, such a step would be far more precisely tailored to the Commission's stated objective of communicating price signals to producers. But the Commission declined to do so, denying that any

In this context, the Commission's action results in a rate structure so prejudicial to Trunkline's ability to recover its costs as to be confiscatory and therefore unlawful. As the Court of Appeals for the Tenth Circuit said in a similar context:

> We cannot condone Commission action which, on the one hand, allows producer price increases to pipeline companies, and, on the other hand, denies the pipeline companies a return on the investments they necessarily incur in serving their customers while simultaneously incurring the increased producer prices.

Cities Service Gas Co. v. FERC, 627 F.2d 1027, 1031 (10th Cir. 1980). The Tenth Circuit correctly described this state of affairs as "arbitrary." *Id.* The Commission's new orders enforce equally arbitrary results which

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"nexus" existed between minimum bill provisions and take-or-pay liability on the ground that the failure of a single customer to purchase its minimum bill quantity of gas would not in all cases automatically cause the incurrence of an equivalent amount of take-or-pay costs by the pipeline. Pet. App. D at A-103 to A-104. The Court of Appeals affirmed, holding that the two matters were not "inextricably" related and that the Commission could therefore address the minimum bill issue while "deferring" corresponding take-or-pay relief. Pet. App. A at A-38 to A-40. But this hypertechnical response is inadequate, in the case of a pipeline in Trunkline's position, to prevent the gross monetary losses that will result from the potential massive loss of Trunkline's sales market combined with the immense and escalating take-or-pay exposure that will result from Trunkline being unable to sell its minimum bill quantities. Ironically, if Trunkline purchased from another pipeline, it would be permitted to pass through any remaining minimum bill of its seller in its own minimum bill, pursuant to the Court of Appeals remand. No such protection is provided Trunkline as a direct purchaser from producers. Finally, the Court of Appeals' holding was based on the understanding that the Commission was only "deferring" action on the take-or-pay issue, a concept that originated with the Commission, but has now been abandoned. *See Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol (Order No. 436)*, 49 Fed. Reg. at 42,462.

deprive pipelines of property interests without due process or just compensation.

CONCLUSION

There are two separate grounds on which the Commission's orders affirmed by the Court of Appeals should be reviewed by this Court. The first is that in attempting to impose a new market structure incorporating unbridled inter-pipeline competition and unrestricted "marketplace" pricing, the Commission has violated the public utility form of pipeline regulation envisioned by the NGA and the NGPA. The second is that the practical effect of the Commission's actions is to impose confiscatory rate levels on pipelines that have acquired new supplies in good faith efforts to fulfill the mandate of the NGPA. In both ways, the Court of Appeals' sanction of the Commission's action threatens the entire regulatory fabric of the NGA and the NGPA. Certiorari is therefore warranted.

Respectfully submitted,

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APPENDICES

TRUNKLINE/PANHANDLE APPENDIX A

NATURAL GAS ACT

§ 4(a), 15 U.S.C. § 717c(a)

All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is declared to be unlawful.

§ 4(e), 15 U.S.C. § 717c(e)

Whenever any such new schedule is filed the Commission shall have authority, either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go

into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

TRUNKLINE/PANHANDLE APPENDIX B

NATURAL GAS POLICY ACT OF 1978

§ 601, 15 U.S.C. § 3431

(a) Jurisdiction of the Commission under the Natural Gas Act

(1) Sales

(A) Natural gas not committed or dedicated

For purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)], effective on the first day of the first month beginning after November 9, 1978, the provisions of the Natural Gas Act [15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply to natural gas which was not committed or dedicated to interstate commerce as of November 8, 1978, solely by reason of any first sale of such natural gas.

(B) Committed or dedicated natural gas

Effective beginning on the first day of the first month beginning after November 9, 1978, for purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)], the provisions of such Act [15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply solely by reason of any first sale of natural gas which is committed or dedicated to interstate commerce as of November 8, 1978, and which is—

(i) high-cost natural gas (as defined in section 3317(c)(1), (2), (3), or (4) of this title);

(ii) new natural gas (as defined in section 3312(c) of this title); or

(iii) natural gas produced from any new, onshore production well (as defined in section 3313(c) of this title).

(C) Authorized sales or assignments

For purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)], the provisions of the Natural Gas Act [15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply by reason of any sale of natural gas—

(i) authorized under section 3362(a) or 3371(b) of this title; or

(ii) pursuant to any assigned authorized under section 3372(a) of this title.

(D) Natural-gas company

For purposes of the Natural Gas Act [15 U.S.C. 717 et seq.], the term "natural-gas company" (as defined in section 2(6) of such Act [15 U.S.C. 717a(6) et seq.]) shall not include any person by reason of, or with respect to, any sale of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission do not apply to such sale solely by reason of subparagraph (A), (B), or (C) of this paragraph.

(E) Alaskan natural gas

Subparagraph (B)(ii) and (iii) shall not apply with respect to natural gas produced from the Prudhoe Bay unit of Alaska and transported through the transportation system approved under the Alaska Natural Gas Transportation Act of 1976 [15 U.S.C. 719 et seq.].

(2) Transportation

(A) Jurisdiction of the Commission

For purposes of section 1(b) of the Natural Gas Act [15 U.S.C. 717(b)] the provisions of such Act

[15 U.S.C. 717 et seq.] and the jurisdiction of the Commission under such Act shall not apply to any transportation in interstate commerce of natural gas if such transportation is—

(i) pursuant to any order under section 3362 (c) or section 3363(b), (c), (d), or (h) of this title; or

(ii) authorized by the Commission under section 3371(a) of this title.

(B) Natural-gas company

For purposes of the Natural Gas Act [15 U.S.C. 717 et seq.], the term "natural-gas company" (as defined in section 2(6) of such Act [15 U.S.C. 717a (6)]) shall not include any person by reason of, or with respect to, any transportation of natural gas if the provisions of the Natural Gas Act and the jurisdiction of the Commission under the Natural Gas Act do not apply to such transportation by reason of subparagraph (A) of this paragraph.

(b) Charges deemed just and reasonable

(1) Sales

(A) First sales

Subject to paragraph (4), for purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid in any first sale of natural gas shall be deemed to be just and reasonable if—

(i) such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter; or

(ii) there is no applicable maximum lawful price solely by reason of the elimination of price controls pursuant to part B of subchapter I of this chapter.

(B) Emergency sales

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid in any sale authorized under section 3362(a) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established under such section and applicable to such sale.

(C) Sales by intrastate pipelines

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d] any amount paid in any sale authorized by the Commission under section 3371(b) of this title shall be deemed to be just and reasonable if such amount does not exceed the fair and equitable price established by the Commission and applicable to such sale.

(D) Assignments

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid pursuant to the terms of any contract with respect to that portion of which the Commission has authorized an assignment authorized under section 3372 (a) of this title shall be deemed to be just and reasonable if such amount does not exceed the applicable maximum lawful price established under subchapter I of this chapter.

(E) Affiliated entities limitation

For purposes of paragraph (1), in the case of any first sale between any interstate pipeline and any affiliate of such pipeline, any amount paid in any first sale shall be deemed to be just and reasonable if, in addition to satisfying the requirements of such paragraph, such amount does not exceed the amount

paid in comparable first sales between persons not affiliated with such interstate pipeline.

(2) Other charges

(A) Allocation

For purposes of sections 4 and 5 of the Natural Gas [15 U.S.C. 717c, 717d], any amount paid by any interstate pipeline for transportation, storage, delivery or other services provided pursuant to any order under section 3363(b), (c), or (d) of this title shall be deemed to be just and reasonable if such amount is prescribed by the President under section 3363 (h)(1) of this title.

(B) Transportation

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], any amount paid by any interstate pipeline for any transportation authorized by the Commission under section 3371(a) of this title shall be deemed to be just and reasonable if such amount does not exceed that approved by the Commission under such section.

(c) Guaranteed passthrough

(1) Certificate may not be denied based upon price

The Commission may not deny, or condition the grant of, any certificate under section 7 of the Natural Gas Act [15 U.S.C. 717f] based upon the amount paid in any sale of natural gas, if such amount is deemed to be just and reasonable under subsection (b) of this section.

(2) Recovery of just and reasonable prices paid

For purposes of sections 4 and 5 of the Natural Gas Act [15 U.S.C. 717c, 717d], the Commission

may not deny any interstate pipeline recovery of any amount paid with respect to any purchase of natural gas if—

> (A) under subsection (b) of this section, such amount is deemed to be just and reasonable for purposes of sections 4 and 5 of such Act [15 U.S.C. 717c, 717d], and
>
> (B) such recovery is not inconsistent with any requirement of any rule under section 3341 of this title (including any amendment under section 3342 of this title),

except to the extent the Commission determines that the amount paid was excessive due to fraud, abuse, or similar grounds.